INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute and regulations involved	2
Statement	2
Summary of argument	4
Argument	5
Conclusion	13
Appendix	14–16

CITATIONS

Cases:

Atlantic Cleaners & Dyers v. *United States*, 286 U.S. 427 — 11

Commissioner v. *Independent Life Ins. Co.*, No. 689, current term — 4, 5, 6

Commissioner v. *Lafayette Life Ins. Co.*, 67 F. (2d) 209 — 9

Crooks v. *Harrelson*, 282 U.S. 55 — 11

Diamond Alkali Co. v. *Heiner*, 60 F. (2d) 505, reversed, 288 U.S. 502 — 10

Lewis v. *Commissioner*, 47 F. (2d) 32 — 11

Murphy Oil Co. v. *Burnet*, 287 U.S. 299 — 9

Northern Trust Co. v. *United States*, E.D.Mo., decided December 15, 1932 (333 C.C.H., p. 8145) — 11

Scott, Oreon E., v. *Commissioner*, C.C.A. 8th, decided February 16, 1934 (343 C.C.H., p. 9489) — 12

Statute:

Revenue Act of 1928, c. 852, 45 Stat. 791:

Sec. 23 — 10

Sec. 202 — 8, 14

Sec. 203 — 8, 10, 14

Sec. 204 — 10

Miscellaneous:

Treasury Regulations 74, Art. 976 — 16

H.Rep. No. 350, 67th Cong., 1st Sess., p. 14 — 9

S.Rep. No. 275, 67th Cong., 1st Sess., p. 20 — 9

In the Supreme Court of the United States

OCTOBER TERM, 1933.

No. 722

ROCKFORD LIFE INSURANCE COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 15) is not reported. The opinion of the Circuit Court of Appeals (R. 23) is reported in 67 F. (2d) 213.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered October 20, 1933 (R. 24). The petition for a writ of certiorari was filed January 17, 1934, and was granted February 5, 1934 (R. 25). The

jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether it is within the competency of Congress to deny deductions for real estate expenses and depreciation connected with the home office building of a life insurance company which owns the building and receives substantially no rent therefrom.

2. Whether a life insurance company which pays taxes only upon its investment income may deduct depreciation upon furniture and fixtures used in its underwriting department as well as those used in its investment department.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra,* pp. 14–16.

STATEMENT

The facts, as stipulated by the parties (R. 13–15) and found by the Board of Tax Appeals (R. 15), are substantially as follows:

Petitioner is a life insurance company incorporated under the laws of Illinois. During 1929 petitioner owned and occupied a building which it acquired in 1926 at a total cost of $77,524.21. The book value as of December 31, 1929, was $71,176.23 (R. 13).

During 1929 petitioner occupied the entire building and received therefrom only $15 rent. In the same year the building suffered depreciation of $1,813.71 and the petitioner expended upon the building $1,808.03 as taxes and $411.31 as expenses for ordinary and necessary repairs. (R. 13.) These three items were deducted by petitioner in its return for the year 1929 (R. 15), but petitioner did not include in its gross income the rental value of the space occupied by it (R. 14). Petitioner also deducted the full amount of depreciation on furniture and fixtures used in its business.

The Commissioner of Internal Revenue disallowed the deductions claimed for taxes, expenses and depreciation on the building (R. 14, 15). He further held that depreciation on furniture and fixtures was allowable only with respect to such of those assets as were used in the investment department. In the absence of any specific allocation of the cost of such assets to the investment department, the Commissioner computed the allowance upon the basis of the ratio of investment income to total income, which resulted in an allowance of $292.56. (R. 7, 14.)

These adjustments resulted in the finding of a deficiency of $607.53 (R. 8). Petitioner appealed to the Board of Tax Appeals, which found that there was no deficiency and determined an overpayment of $750.05 (R. 16). The Circuit Court of Appeals reversed the decision of the Board (R. 24), and this Court granted certiorari (R. 25).

SUMMARY OF ARGUMENT

I

The first question has to do with the constitutionality of the provision of the revenue acts allowing life insurance companies to deduct from gross income the taxes, expenses and depreciation on real estate which they own and occupy, only upon condition that they include in gross income an amount representing the rental value of the space occupied by them. This question is discussed in the brief for the petitioner in *Commissioner* v. *Independent Life Ins. Co.*, No. 689, current term, to which the Court is respectfully referred.

II

The second question has to do with the allowance for depreciation of furniture and fixtures. The provision of the statute upon which petitioner relies authorizes a " reasonable " allowance for depreciation. This allowance is deductible from " gross income ", which includes only investment income. The Congressional policy to correlate deductions allowed life insurance companies to the limited income upon which they are taxed is clearly revealed by the statute and the committee reports. In view of this policy the court below held that an allowance for depreciation of furniture and fixtures used in the investment part of the business, without

any corresponding allowance in respect of furniture and fixtures used in the underwriting departments, constitutes a reasonable allowance within the meaning of the statute. We submit that any other allowance would be unreasonable. The decision is obviously in harmony with the purpose of Congress and is an accord with decisions which have been rendered in analogous situations.

ARGUMENT

I

The facts here differ slightly from those in *Commissioner* v. *Independent Life Ins. Co.*, No. 689, current term, although both cases involve the constitutionality of the provisions of the revenue laws relating to taxes, expenses, and depreciation on real estate owned and occupied by life insurance companies. Petitioner occupied the entire home office building, receiving only $15 by way of rent (R. 13). In its income-tax return for 1929 it claimed as deductions on account of the property sums aggregating $4,033.05, but did not include in gross income any amount representing the rental value of the space which it occupied (R. 13, 15). The Commissioner, instead of adding such rental value to its gross income, simply disallowed the deductions, presumably for the reason that they were less than the rental value which petitioner would

have had to report.[1] The result was more favorable to petitioner than if the Commissioner had allowed the deductions and added the rental value of the space occupied.

It is apparent, therefore, that petitioner is not in a position to contend that it has been subjected to a direct tax on its real estate. The only question open here is whether Congress could properly deny petitioner the privilege of deducting taxes, expenses, and depreciation on property which, for the most part, was productive of no taxable income. The purpose and practical effect of the statute are discussed at length in the brief for the petitioner in *Commissioner* v. *Independent Life Ins. Co.*, No. 689, current term. For the reasons there stated we submit that the limitation on the deductions, which in the case at bar results in the allowance of no deductions at all, is reasonable and within the competency of Congress.

The facts of this case furnish a striking illustration of the necessity for such a limitation. As has been stated, the building produced only $15 of taxable income. Yet the company seeks to deduct $4,033.05, by far the greater part of which must have related to the production of income which was

[1]

4 percent of book value	$2,847.05
Plus expenses, depreciation, taxes	4,033.05
	6,880.10
Minus rents from tenants	15.00
Rental value to be added	6,865.10

not taxable. Surely it cannot be said that the disallowance of the deductions in these circumstances is arbitrary or unreasonable. The $4,033.05 is analogous to the rent which the company would have to pay if it did not own its home office, and which would not be deductible under the statute. The statute, therefore, as applied here, makes for equality rather than inequality between a company which occupies its own building and one which does not. The inclusion of this amount in the computation of the tax liability would result in a tax upon something other than the net investment income which both Congress and the companies contemplated should be the subject of the tax.

II.

The Commissioner's action with respect to the allowance for depreciation of furniture and fixtures is not challenged upon any constitutional ground. The question presented is solely one of statutory construction.

The Commissioner prepared a depreciation schedule which showed that petitioner's furniture and fixtures had suffered depreciation in 1929 of $1,783.02 (R. 9). However, since the furniture and fixtures were used in the production of both investment income and underwriting income, he determined that a reasonable amount to be de-

ducted from investment income alone should be computed on the basis of the ratio of investment income to the total income. The total income was found to be $751,147.77, and the investment income $123,248.44. Using that ratio the Commissioner found that a reasonable deduction amounted to $292.56. (R. 7.)

Petitioner does not dispute the accuracy of the calculation but asserts a right to deduct the whole amount of depreciation, because of the absence of any limiting language in Section 203 (a) (7) (*infra,* p. 15). That section provides that the "gross income" may be reduced by "a reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence." While there is no language in the subsection specifically limiting the allowance, there is limiting language in the definition of "gross income" which the deduction serves to reduce. Section 202 (a) limits gross income to that received from interest, dividends and rents, and Congress undoubtedly intended that the deductions should bear some relation to that limited income. The income from capital gains and the underwriting business is not taxed, and if the expense of earning this untaxed income were permitted to reduce the taxable income there would be the paradox of omitting certain income from the tax and reducing the remainder by the expenses of earning the omitted income.

The general policy with respect to the taxation of life insurance companies was revealed in the committee reports relative to the 1921 Act, where the following statement appears (67th Cong., 1st Sess., S.Rep. No. 275, p. 20; see also H.Rep. No. 350, p. 14):

> The proposed plan would tax life insurance companies on the basis of their investment income from interest, dividends, and rents, *with suitable deductions for expenses fairly chargeable against such investment income.* (Italics ours.)

The purpose of Congress to correlate deductions to the limited income taxed is further disclosed by other provisions of the statute. Section 203 (a) (5) limits the deductible business expenses to those concerned with the investment business, and Section 203 (b), as has been observed, imposes a condition upon the deductions for real estate expenses and depreciation, which is designed to prevent the deduction of expenses properly attributable to the production of income which is not taxed.

In view of this policy the court below held in *Commissioner* v. *Lafayette Life Ins. Co.*, 67 F. (2d) 209, that depreciation on furniture and fixtures used in the investment business alone constituted a reasonable allowance within the meaning of the statute. The case at bar was decided upon the authority of that decision (R. 24). It is evident that some weight must be given to the word "reasonable" in the statute. Cf. *Murphy Oil Co.* v. *Bur-*

net, 287 U.S. 299. To be "reasonable" the allowance must be, as the term implies, just, fair, and equitable. *Diamond Alkali Co.* v. *Heiner,* 60 F. (2d) 505, 510 (C.C.A. 3d), reversed on another issue, 288 U.S. 502. And we submit that it would be unreasonable to allow a deduction for the expenses of earning nontaxable income.

Nor is there any incongruity in computing the reasonable allowance under Section 203 (a) (7) in a different manner from the allowance under Section 23 (k) which is applicable to corporations generally. Section 203 (a) (7) does not refer to Section 23 (k), and the structure of the statute shows that Congress did not mean the same thing in both sections. Insurance companies other than life or mutual are taxable under Section 204. In the case of such companies gross income includes investment income, underwriting income, and capital gains. Section 204 (b) (1). Thus, the statute reaches all of the income of such companies and places them on a parity with corporations generally. It is, therefore, appropriate that they have similar deductions, and it is found that Section 204 (c) (9) permits the deduction of "a reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23 (k)." We submit that the omission from Section 203 (a) (7) of a reference to Section 23 (k) is significant and lends support to our contention that Congress did not intend to allow life insurance companies to compute depre-

ciation on the same basis as corporations which were taxed on all of their income. This Court has recently pointed out that the same word may have different meanings when used more than once, even in the same section of a statute (*Atlantic Cleaners & Dyers* v. *United States,* 286 U.S. 427, 433), and we submit that there is a valid reason for making a distinction here, and that Congress undoubtedly had it in mind.

The result reached below is consistent with the decision in *Lewis* v. *Commissioner,* 47 F. (2d) 32 (C.C.A. 3d), where a taxpayer receiving both exempt and taxable income was limited in his deductions for expenses to those fairly attributable to the earning of taxable income. There was no statutory authority for limiting the allowance in that case, but the decision was based upon (p. 34) "the common sense meaning of the words of the statute" when read in connection with the evident policy of Congress.

The same principle was applied in *The Northern Trust Co.* v. *United States* (E.D.Mo.), decided December 15, 1932, not officially reported, but see 333 C.C.H., p. 8145, where it was held that since, under *Crooks* v. *Harrelson,* 282 U.S. 55, Missouri real estate could not be included in the gross estate for the purpose of computing the estate tax, neither could the executor's commission for handling such real estate be allowed as a deduction. A contrary result has recently been reached in *Oreon E. Scott*

v. *Commissioner* (C.C.A. 8th), decided February 16, 1934, not yet officially reported, but see 343 C.C.H., p. 9489, where it was held that commissions paid executors for selling Missouri real estate were deductible. However, the Circuit Court of Appeals' decision is based upon its conclusion (p. 9490) that the statute "'expressly leaves the meaning of 'administration expenses' to the State law" and that the State law compensates the executor "for all services rendered in the management and disposition of the *entire* estate." (Italics by the court.) Accordingly, that decision does not in any way weaken the principle for which we contend here. The effect of that decision is that the statute itself made the principle inapplicable in that case.

We submit that the statute here involved has been correctly construed to limit deductions from gross income to those items bearing a relation to the gross income. The record plainly shows that the investment income (gross income) comprised only one sixth of the total income (R. 7). Hence, it is logical to suppose that the depreciation of the furniture and fixtures was due largely to its use in the production of nontaxable income. The allowance of the full amount of the depreciation under these conditions would not be a " reasonable " deduction within the terms of the statute.

CONCLUSION

The decision below should be affirmed.

Respectfully submitted.

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APRIL 1934.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791, 842:

SEC. 202. GROSS INCOME OF LIFE INSURANCE COMPANIES.

(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—

* * * * * *

(5) *Investment expenses.* — Investment expenses paid during the taxable year: *Provided,* That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(6) *Real estate expenses.* — Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for

permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder of a company upon his interest as shareholder, which are paid by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes;

(7) *Depreciation.* — A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence;

(8) *Interest.* — All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title; and * * *.

* * * * *

(b) *Rental value of real estate.*—No deduction shall be made under subsection (a) (6) and (7) of this section on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

Treasury Regulations 74 (promulgated under the Revenue Act of 1928):

ART. 976. *Home office properties.*—No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 per cent per annum of the book value at the end of the taxable year of the real estate so owned and occupied. For example, if the book value of a parcel of real estate owned and occupied in whole or in part by the company is $1,000,000, the rents received from other tenants $30,000, taxes and expenses $40,000, and depreciation $20,000, the company would have to include in its gross income a sum not less than $70,000 ($40,000 taxes and expenses, plus $20,000 depreciation, minus $30,000 rents from tenants, plus 4 per cent of $1,000,000) as the rental value of the space occupied by it in order to avail itself of the deductions of $40,000 and $20,000. In any case the rents received from other tenants must be included in gross income.

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